COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Fitchburg Gas and Electric Light Company	)	D.T.E.01-103
Reconciliation Mechanism Filing	)	

DIRECT TESTIMONY OF DAVID J. EFFRON

On behalf of

THE OFFICE OF THE ATTORNEY GENERAL

June 24, 2002

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I. STATEMENT OF QUALIFICATIONS

Q. Please state your name and business address.

A. My name is David J. Effron. My business address is 386 Main Street, Ridgefield, Connecticut.

Q. What is your present occupation?

A. I am a consultant specializing in utility regulation.

Q. Please summarize your professional experience.

A. My professional career includes over twenty years as a regulatory consultant, two years as a supervisor of capital investment analysis and controls at Gulf & Western Industries and two years at Touche Ross & Co. as a consultant and staff auditor. I am a Certified Public Accountant and I have served as an instructor in the business program at Western Connecticut State College.

Q. What experience do you have in the area of utility rate setting proceedings?

A. I have analyzed numerous electric, telephone, gas and water rate filings in different jurisdictions. Pursuant to those analyses I have prepared testimony, assisted attorneys in rate case preparation, and provided assistance during settlement negotiations with various utility companies.

I have testified in over two hundred cases before regulatory commissions in Alabama, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Kansas, Kentucky, Maryland, Massachusetts, Missouri, New Jersey, New York, North

Dakota, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, and Virginia.

Q. Please describe your other work experience.

A. As a supervisor of capital investment analysis at Gulf & Western Industries, I was responsible for reports and analyses concerning capital spending programs, including project analysis, formulation of capital budgets, establishment of accounting procedures, monitoring capital spending and administration of the leasing program. At Touche Ross & Co., I was an associate consultant in management services for one year and a staff auditor for one year.

Q. Have you earned any distinctions as a Certified Public Accountant?

A. Yes. I received the Gold Charles Waldo Haskins Memorial Award for the highest scores in the May 1974 certified public accounting examination in New York State.

Q. Please describe your educational background.

A. I have a Bachelor's degree in Economics (with distinction) from Dartmouth College and a Masters of Business Administration Degree from Columbia University

II. PURPOSE AND SUMMARY OF TESTIMONY

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the Office of the Attorney General.

Q. What is the purpose of your testimony?

A. I have reviewed the Electric Reconciliation Mechanism and Inflation Adjustment Filing by Fitchburg Gas and Electric Light Company ("FG&E" or "the Company"), dated December 3, 2001. Pursuant to that review, I am proposing certain adjustments to the reconciliation of revenues and costs by FG&E. In particular, I am proposing certain modifications to the reconciliation of transition charge ("TC") revenues and costs. I am also recommending a modification to the method of calculating carrying costs on the cumulative under or over-recovery balances of the charges subject to reconciliation.

Q. Please summarize your conclusions.

A. The residual value credit to the recovery of transition costs should be adjusted, to recognize carrying costs on the proceeds from the sale of New Haven Harbor and to modify the calculation of lost revenue. Carrying costs on the cumulative under or over-recovery balances of the charges by FG&E subject to reconciliation should be calculated on the balance net of income taxes.

III. TRANSITION CHARGE

A. RESIDUAL VALUE CREDIT

Q. Have you reviewed the Company's calculation of the residual value credit ("RVC)?

A. Yes. The Company's calculation of the RVC is contained on Schedule MHC-2, Pages 7 – 10, accompanying the testimony of Mr. Collin. The purpose of the RVC is to recognize the proceeds from the divestiture of the generating units as an offset to the fixed cost recovery in the transition charge.

Q. How is the RVC calculated?

A. First, the net proceeds are determined by beginning with the gross proceeds from the plant sale and then adjusting the gross proceeds for plant additions after 1995, book value of items included in the sale that were not included in the fixed cost recovery (such as fuel and M&S inventories), transaction costs, site clean-up costs, and lost revenue. The net proceeds are then amortized, with a return on the unamortized net of tax balance, through 2009. FG&E has calculated the annual RVC such that the total of the amortization plus return is equal in each year, similar to a levelized stream of mortgage payments.

Q. Should the RVC calculated by FG&E be modified?

A. Yes. There should be two modifications. First carrying costs should be recognized on the net of tax proceeds from the sale of New Haven Harbor from the time of the sale until the start date for the RVC. Second, the lost revenue offset to the divestiture proceeds should be adjusted. In addition, there should be certain modifications to the tax basis used to calculate the after-tax gain on the divestiture of New Haven Harbor, Turbine #7, and Millstone 3.

1. Sale of New Haven Harbor

Q. When was the sale of the Company's share of the New Haven Harbor plant completed?

A. The sale was completed on April 14, 1999 (response to AG-2-1).

Q. When was this in relation to the start date for the RVC?

A. The Company begins the RVC on February 1, 2000. Thus, the sale of New Haven Harbor was completed 9.5 months before the start date for the RVC.

Q. Has FG&E recognized any carrying charges from the time of the sale of New Haven Harbor until the customers are credited for the proceeds of the sale through the RVC?

A. No. Based on its presentation, FG&E would get to keep the time value of the proceeds from the date of the sale until the RVC is credited against the transition costs.

Q. Is this consistent with the Company's treatment of other components of the RVC and transition charge?

A. No. For example, with regard to lost revenue, which is a cost that is offset against sale proceeds in the calculation of the RVC, the Company computes carrying charges from the time the lost revenue cost is incurred until the lost revenue is charged against the proceeds at the commencement of the RVC.

Q. Should carrying costs be computed on the net proceeds from the sale of New Haven Harbor from the time of the sale until the start date for the RVC?

A. Yes. If it is appropriate to recognize carrying charges on costs, such as the lost revenue, then it is also appropriate to recognize carrying charges on the net proceeds from the sale until the time that RVC commences. If there is no return on the proceeds from the time of the sale until the commencement of the RVC, then the ratepayers are not properly credited for the time value of the proceeds during that interval.

Q. Have you calculated the carrying costs on the net proceeds from the sale of New Haven Harbor from the time of the sale until the start date for the RVC?

A. Yes. On Schedule DJE-1, Page 3, I have calculated the carrying charges by applying the Company's rate of return to the after tax proceeds from the sale for the period from the time of the sale of New Haven Harbor until the implementation of the RVC. Using this method, I have calculated carrying charges of $275,000. This amount should be added to the proceeds from the sale of New Haven Harbor in calculating the Company's residual value credit.

2. Lost Revenue

Q. Have you reviewed the Company's lost revenue calculation?

A. Yes. Lost revenue is an offset to the proceeds from divestiture in the calculation of the RVC. The Company's calculation of lost revenue is described in the testimony of Mr. Collin at page 32-39, with the actual calculations being contained in Schedules MHC-4 and MHC-5. FGE&E has calculated total lost revenue of $2,830,000.

Q. What is your understanding of what the Company is authorized to include in the lost revenue component of the RVC?

A. My understanding of what the Company is authorized to include in lost revenue is based on the Department's order in D.T.E. 99-110 at page 27, where the Department stated:

> The Department last approved a representative level of A&G and O&M costs related to the generation of electricity in the Company's most recent base rate proceeding, Fitchburg Gas and Electric Light Company, D.P.U. 84-145-A (1985). The Company may recover A&G and O&M costs from its owned generation supply portfolio up to the divestiture date through the lost revenue component of the RVC. The level of costs to be recovered, however, cannot exceed the level of costs approved in D.P.U. 84-145-A. Therefore, we direct the Company to include, as an offset to the RVC, only those owned generating facilities' A&G and O&M costs related to the generation of electricity that were allowed in the rates approved by the Department in D.P.U. 84-145-A for the period March 1998 through the divestiture date.

Based on my reading of this section of the order, the Company is allowed to include operation and maintenance expense related to generation, including properly allocable administrative and general expense, based on the allowance for those expenses in the approved rates in D.P.U. 84-145-A, from March 1, 1998 until the time of divestiture.

Q. Has the Company limited the components of lost revenue to operation and maintenance expense related to generation, including properly allocable administrative and general expense?

A. No. For example the Company included a return and depreciation on generating plant included in the cost of service in D.P.U. 84-145-A (Schedule MHC-5) and then subtracted the fixed costs recovered through the transition charge, thereby including the difference between fixed generating costs in D.P.U. 84-145-A and the recovery of fixed generating costs through the transition charge in the lost revenue. I do not consider this to be consistent with the Department's directive that "only those owned generating facilities' A&G and O&M costs related to the generation of electricity that were allowed in the rates approved by the Department in D.P.U. 84-145-A" are to be included in lost revenue used an offset to the RVC.

Q. Have you recalculated the expenses to be recovered through the lost revenue adjustment to the RVC?

A. Yes. On Schedule DJE-2, Page 4, I have calculated the operation and maintenance expense, including administrative and general expense, related to the generation of electricity that were allowed in the rates approved by the Department in D.P.U. 84-145-A on a per kWh basis. As can be seen on this schedule, I have calculated generation related expenses of $0.00383 per kWh, as compared to the $0.00870 calculated by the Company. This $0.00383 per kWh is the appropriate lost revenue factor as of March 1, 1998.

Q. Should the $0.00383 per kWh remain in effect for the entire time from March 1, 1998 until the implementation of the RVC for the purpose of calculating the lost revenue?

A. No. The Company's ownership of the Turbine #7 generating unit terminated October 1, 1998, and the New Haven Harbor plant was sold on April 14, 1999. The residual value credit was not implemented until February 1, 2000. The $0.00383 per kWh should be modified to reflect the termination of the Turbine #7 ownership and the sale of New Haven Harbor prior to the implementation of the RVC.

Q. Why should the $0.00383 per kWh be modified to reflect the termination of the Turbine #7 ownership and the sale of New Haven Harbor?

A. The lost revenue represents generation operation and maintenance expense related to the Company's owned generation until the divestiture date. Once a generating unit is divested, there is no lost revenue related to that unit, as the Company no longer incurs operation and maintenance expense related to that unit and has no rightful claim to revenue to cover those expenses. Therefore, subsequent to divestiture of a given generating unit, the Company should not continue to recover lost revenue related to that generating unit. This is also consistent with my understanding of the Department's directive that the recovery of lost revenue should continue "for the period March 1998 through the divestiture date."

Allowing recovery of lost revenue related to O&M for a divested generating unit would be to allow recovery of a cost that the Company had ceased to incur.

Q. Have you calculated the lost revenue factor subsequent to the termination of the Turbine #7 ownership and the divestiture of New Haven Harbor?

A. Yes. Of the $0.00383 per kWh effective March 1, 1998, $0.00041 is operation and maintenance expense, including administrative and general, related to Turbine #7, and $.00325 is operation and maintenance expense, including administrative and general, related to New Haven Harbor (Schedule DJE-2, Page 4). Therefore, subsequent to the termination of the Turbine #7 ownership, the lost revenue factor should be adjusted to $0.00343 per kWh. Subsequent to the divestiture of New Haven Harbor, the lost revenue factor should be adjusted to $0.00018 per kWh (Schedule DJE-2, Page 4). This last factor should remain in effect through the implementation of the RVC, February 1, 2000.

Q. With these proposed modifications what lost revenue have you calculated?

A. I have calculated lost revenue of $211,000 (Schedule DJE-2, Page 3), including a return on the net of tax balance of lost revenue until January 31, 2000.

Q. Why did you calculate a return on the net of tax balance rather than the pre-tax balance?

A. The net of tax balance represents the actual net cash outlay by the Company to fund these costs. That is, to the extent that recoverable lost revenue exceeds the market value of the output of the plants, the excess is deductible for income taxes. Therefore, it is only the net of tax balance that must be funded, and this is the balance that should accrue a return.

3. Tax Basis of Divested Plant

Q. Please describe the necessary modifications to the tax basis used to calculate the after-tax gain on the divestiture of New Haven Harbor, No. 7 Turbine, and Millstone 3.

A. In the response to Attorney General Information Request AG-1-2, the Company stated that the tax basis for No.7 Turbine and the tax basis for New Haven Harbor shown on Schedule MHC-2, Page 8 should be corrected. In the response to Attorney General Information Request AG-1-4, the Company stated that the tax basis for Millstone 3 shown on Schedule MHC-2, Page 10 should be corrected. In addition, on Schedule on Schedule MHC-2, Page 7, the Company deducted certain items such as fuel inventory in calculating the net proceeds from divestiture. Based on the response to Attorney General Information Request AG-1-2, the Company also included these items in the tax basis on Schedule MHC-2, Page 8. This results in a double counting of the tax basis of these items and an understatement of the income taxes on the divestiture.

Q. Have you recalculated the RVC to reflect your proposed modifications?

A. Yes. I have calculated a RVC of $539,000 to be effective February 1, 2000 (Schedule DJE-1, Page 1) and an additional RVC of $61,000 to be effective April

1, 2001 (Schedule DJE-1, Page 4). Thus, I am proposing a RVC of $539,000 for 2000 and a RVC $600,000 for the years 2001 – 2009, rather than the $176,000 and $246,000 respectively, as reflected by the Company in its reconciliation.

B. COMPUTED INTEREST

Q. Has the Company calculated interest (or carrying charges) on the cumulative balances of the over or under recoveries of the charges subject to reconciliation?

A. Yes. For each of the charges, FG&E has computed interest on the cumulative over or under recovery for each month in the reconciliation period. The interest is computed by applying the relevant interest rate to the average cumulative balance of the monthly over or under recovery.

Q. Is the balance to which the interest rate is applied stated on a pre-tax or after-tax basis?

A. The balance is stated on a pre-tax basis.

Q. Does the pre-tax balance represent the net funds required to support an under recovery or the net funds provided by an over-recovery?

A. No. If the costs related to a particular item, for example the transition charge, are greater than the revenues recovered for that item, then the excess of costs over revenues is deductible for income taxes, leading to a reduction to income taxes payable. Similarly, if the revenues are greater than the costs, the difference is subject to income taxes, leading to an increase in income taxes payable. Thus, the net funds required to support an under recovery, or the net funds provided by an over recovery, are the amounts net of applicable income taxes.

Q. Should the Company's method of computing interest be modified?

A. Yes. The interest is meant to compensate investors for the required return on the net investor supplied funds necessary to support any under recovery or to compensate ratepayers for the net ratepayer supplied funds from any over recovery. The net funds required or supplied are the over or under recoveries net of taxes. That is, just as an under recovery requires funds, the tax deduction related to that under recovery provides funds; just as an over recovery provides funds, the taxes related to that under recovery requires funds. Therefore, the interest should be calculated by applying the relevant interest rate to the cumulative monthly balance of the under or over recovery net of income taxes. Calculating the interest on the balance net of taxes properly recognizes the carrying costs on the net funds required by an under recovery or the carrying costs on the net funds provided by an over recovery.

Q. Does this complete your testimony?

A. Yes.